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AD HOC INTERGOVERNMENTAL WORKING GROUP
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ALLEGED CASES OF FRAUD IN THE UNITED NATIONS: STUDY OF THE POSSIBILITY OF THE ESTABLISHMENT OF A NEW JURISDICTIONAL AND PROCEDURAL MECHANISM OR OF TH' EXTENSION OF MANDATES AND IMPROVEMENT OF THE FUNCTIONING OF EXISTING JURISDICTIONAL AND PROCEDURAL MECHANISMS

Observations regarding measures to reduce alleged cases of fraud

Views of Mr. Lelong, expert representing the Government of France

In this communication, which is being submitted for consideration at the second session (13-17 June 1994) of the Ad Hoc Intergovernmental Working Group of Experts established pursuant to General Assembly resolution 48/218, the French Government wishes to raise three points:

(1) What is the mandate of the Working Group?

(2) What substantive conclusions should be drawn from the Working Group's first session?

(3) Why is a committee to detect budgetary irregularities necessary?

I. MANDATE OF THE WORKING GROUP

General Assembly resolution 48/218 established the Working Group in order to "address alleged cases of fraud". The actual terms of the Working Group's mandate from the General Assembly need to be analysed first so that the Group's priority tasks can be identified.

To begin with, the Assembly's reference to "alleged cases of fraud" is not a casual one. This is because the problem of fraud in its entirety is far too vast to be considered meaningfully in three short five-day sessions. The concept of fraud is a difficult one to grasp precisely. It is not defined by everyone in the same way. It does, however, imply intent or the existence of actions designed to deceive others, and the intent or actions can only be confirmed, with difficulty, after the fact.

It is one thing to identify, prosecute and punish the perpetrators and/or beneficiaries of fraud. It is quite another thing to study the objective conditions that give rise to fraud in the first place - possible regulatory inadequacies, negligence or serious error on the part of the approving and/or certifying officer; this is the task set in resolution 48/218, namely to "address alleged cases of fraud".

On the one hand, this involves the perpetrators of fraud and ways of dealing with them (disciplinary measures within the United Nations and civil and criminal action in the appropriate courts). On the other hand, it has to do with the search for preventive measures within the Organization itself and its financial system that can reduce the number of cases of presumptive fraud. These two goals, although complementary, are separate. They must therefore be approached differently and in sequence, starting with the one targeted in the specific mandate given in resolution 48/218, namely the alleged cases of fraud.

To do otherwise would be to deny that there was any room for improvement in the Organization's financial management system, while blaming its weaknesses entirely on unscrupulous staff members. This is surely not what the General Assembly had in mind.

II. OUTCOME OF THE FIRST SESSION OF THE WORKING GROUP (11-15 APRIL 1994)

The meetings with key figures in the existing system of financial control were valuable because they showed the Working Group that:

1. The Financial Regulations and Rules are unclear, incomplete and relatively inaccessible, at least in the view of some of those who addressed the Working Group. At the very least, then, there is some doubt as to the quality of the financial norms which certifying officers are supposed to apply. If questioned, the national experts participating in the work of the Board of Auditors would probably confirm this criticism;

2. The only operational criterion used to evaluate the conduct of approving and certifying officers was compliance (or non-compliance) with the prescribed budget management norms. The term currently used by representatives of the Controller's Office is "misconduct", since the Office cannot use the term "fraud".

It would be worthwhile, then, for the Working Group to focus on this concept (which in all likelihood is closely related to the concept of blatant irregularity, associated with the concept of undue financial gain) rather than

worry about detecting fraud per se when reviewing prevention mechanisms; to do the latter would be futile, since by definition an act of fraud can be defined as such only after it has been committed, given the element of intent and the deception that must be proved. This confirms what was stated earlier with regard to the Working Group's mandate from the General Assembly;

3. The number of staff engaged in internal control is very low - a total of 40 individuals, according to the experts;

4. An inadequate response was given to the question of whether the full roster of approving officers, designated approving officers, certifying officers and designated certifying officers was published, regularly updated and verified by the internal control mechanism. It is thus logical to assume that such a roster is neither available nor used for internal monitoring;

5. There was no answer at all to the question of whether there was any systematic monitoring of the transactions carried out by individual approving or certifying officers, either globally or by means of surveys. Under the circumstances, it can be assumed that such monitoring does not occur within the internal control system;

6. The reply from the representative of the Board of Auditors regarding the number of compliance tests conducted by external auditors as a share of their total workload confirms the report, heard also from other sources, that, notwithstanding the reference to standards of the International Organization of Supreme Audit Institutions (INTOSAI) with which the members of the Board of Auditors claimed to comply, the percentage of compliance tests is quite low as a rule.

A number of conclusions can be drawn from the information obtained by the Working Group:

(a) The Financial Regulations and Rules must be reviewed in their entirety with a view to making them clearer, more complete and more readily accessible.

Annex I provides examples which relate to the rules governing procurement.

While the Working Group simply cannot conduct such a review itself, it might wish to formulate a recommendation to that effect in its report to the General Assembly. The report could suggest that a joint group composed of national experts and representatives of the Secretariat be established to conduct the review;

(b) Internal auditing within the United Nations Secretariat must be strengthened.

The Working Group might submit comments, noting the weakness identified in this document, on the understanding that the implementation of recommendations relating to internal audit are in fact the competence of the Secretary-General;

(c) The Board of Auditors and the internal auditors, once they are in a position to do so, must place greater emphasis in their work on compliance tests.

Of course all these issues are interrelated: the auditors cannot be encouraged to detect management errors when the norms whose application they are to monitor are incomplete, imprecise or inaccessible and there is no specific mechanism prior to the audit for monitoring, observation or possible publication of the errors or irregularities found.

This serves to justify the proposal by the French Government to establish a committee to detect budgetary irregularities.

III. FOR A COMMITTEE TO DETECT BUDGETARY IRREGULARITIES

1. We are not writing on a blank page. The Working Group's proposals must take account of the existing system, must be in keeping with its spirit and must remedy its shortcomings without thereby contradicting what now exists and works.

The principle of dual financial control - internal and external - exists at the United Nations. The strengthening of internal financial control is not directly the Working Group's problem, even though, in its final conclusions, the Group finds it necessary to indicate its concern about this matter (see above).

The role of the Board of Auditors is to certify the accounts and evaluate proper management (cost/benefit ratio) and, at the same time, to verify the regularity of the financial transactions decided upon by the approving officers and approved by the certifying officers. The verification is carried out with due regard to the financial regulations applicable to such transactions, through the analysis of areas of risk and through surveys applied mainly to those areas.

The ultimate goal of the entire financial control system is to make sure that the contributors - that is to say, the Member States - get the maximum benefit for their money. In that respect, the evaluation of proper management is essential. The monitoring of regularity is a different matter. Everyday practical experience shows that respect for a system of financial norms is the most economical and most certain way to ensure proper financial management and a satisfactory cost/benefit ratio. Respect for regularity is a necessary but not sufficient condition for proper financial management.

The placement of emphasis, especially in the public sector, on the monitoring of regularity is a concern shared by most national auditors in the public sphere and by the private experts who often work with them in that sphere. This is evidenced, inter alia, by a very recent study (15 April 1994) prepared by the International Federation of Accountants (IFAC), Public Sector Committee (see extracts, annex II). The larger an organization is and the more differences in education, mentality, legal concepts - in short, differences in behaviour - exist between its various officials, the more necessary it will be to make the control system include respect for certain norms and an auditing of the manner in which that respect is demonstrated.

2. In order to be effective, a system of financial norms must meet a number of conditions:

(1) The norms must be complete, simple, clear and capable of evolving on the basis of experience;

(2) The financial audits - both internal and external - must devote sufficient attention to the manner in which the norms are applied.

In the first place, the most obvious bad practices must be detected. Unless the management system makes provision for self-monitoring, this means a methodical analysis of the areas of risk in management and a sufficient number of survey tests, especially in those areas of risk.

In the second place, the internal and external auditors should, where necessary, draw general conclusions on the basis of the infractions of rules which they detect, with a view to improving those norms on a permanent basis;

(3) From the individual standpoint, infractions of norms, if they are particularly serious, must be examined case by case by a specialized committee whose decisions must be final, that is to say, must have the authority of final judgement.

Why a special committee? Because the norms that must be used as reference are too specific to permit entrusting the monitoring of their application, at least at first instance, to judges other than audit professionals. On appeal, by contrast, an administrative tribunal with general competence may handle the matter.

Why must the decisions be final? Because experience proves that a decision having the authority of final judgement, emanating from audit professionals and definitively fixing the amount of the financial damage suffered by the United Nations will subsequently be very useful in facilitating both the disciplinary action within the Organization itself and possible prosecution before the competent national courts with a view to recovering the sums lost.

3. The committee in question need not be made up of permanent staff members. What is important is that they should possess the necessary guarantees of competence and independence, regardless of whether or not they are part of the Organization.

The committee's secretariat could be provided by that of the Board of Auditors. Operating costs should therefore be limited.

The committee should act solely <u>when a case is referred to it</u>:

- by the Secretary-General;
- by the internal auditor; or
- by the Board of Auditors (external control).

One or another of those three authorities would have the sole power to decide whether or not the person guilty of an instance of mismanagement that is particularly serious, either by its nature or by reason of its consequences, should be brought before the committee. Provision should be made to ensure that no one is brought before the committee unless both of the following two elements exist:

- Non-compliance with the norms to a degree considered sufficiently serious;

- A significant financial loss to the United Nations, regardless of whether or not there was deliberate intent on the part of the person concerned to gain undue financial advantage for himself or for a third person.

The committee could decide to publish or not to publish its decisions, possibly without mentioning the names of the persons concerned. This would constitute the "sanction", it being understood that thereafter the Secretary-General could still, if he wished, institute disciplinary, civil or criminal proceedings against the officials thus designated by the committee.

The cases handled by the committee should, parallel with the actions of the internal audit and of the Board of Auditors, help to discover gradually the points on which the financial regulations could be improved and supplemented.

The existence of the committee would in itself constitute an incentive, especially for the external auditor but also for the internal auditor, to make more frequent checks of financial transactions, taken one by one, that is to say, of the behaviour of those officials (the approving and certifying officers) responsible for carrying them out and their compliance with the norms of budget management. Viewed from the standpoint of the external auditor, the establishment of the committee would be equivalent to an opportunity to set up, as suggested by the aforementioned IFAC study, an additional reporting system specializing in mismanagement cases.

ANNEX I

Some examples of the inadequacy of the Financial Regulations of the United Nations

The establishment of a committee to detect budgetary irregularities should be accompanied by a revision of the Organization's Financial Regulations. The present texts are imprecise and inadequate in a number of places, a few examples of which are given below.

A. Purchasing procedures

Regulation 10.5 states that "tenders for equipment, supplies and other requirements shall be invited by advertisement" but immediately adds, for the sake of the flexibility regarded as essential to the management of a large-scale organization whose operations extend over several continents, "except where the Secretary-General deems that, in the interests of the Organization, a departure from the rule is desirable".

The application of this regulation is explained in the "financial rules", which are established by the Secretary-General and therefore rank lower in the hierarchy of norms.

Under those rules, the powers to conclude contracts are very widely delegated and sub-delegated. For example, in the regional commissions of the United Nations, the responsibility for concluding contracts is reserved not only to the Executive Secretary, a clearly identified functional post, but also to staff members duly authorized by him, that is to say, persons listed by name who would normally be liable to change their posts. The same is true in many decentralized units. The list of those officials by whom "contracts for the purchase, rental or sale of services, supplies, equipment or other requirements shall be entered into on behalf of the United Nations" (rule 110.16) is not systematically kept up to date. As a result, the power to sign contracts is not always precisely defined.

The exceptions to calling for bids or proposals are numerous (see rule 110.19) and defined in an imprecise manner (for example, when "the exigency of the service does not permit the delay attendant upon the issue of invitations to bid or the calling for proposals" or when the "other official authorized ... determines that competitive bidding or calling for proposals will not give satisfactory results".

It is hardly surprising, therefore, that in actuality competitive bidding or even calling for proposals remains the exception. The Board of Auditors has pointed out this situation for many years and, in its report, 1/ observed in particular that "only 17 per cent of 5,444 purchase orders issued during the biennium [1990-1991] at Headquarters was awarded through the bidding process".

The General Assembly (Fifth Committee) recognized the relevance of the observations and recommendations of the Board of Auditors and has repeatedly, in

particular by its resolutions 47/211 of 23 December 1992 (paras. 9 and 10) and 48/216 of 23 December 1993 (part B, paras. 3 and 4), asked the Secretariat for proposals aimed at revision of the Financial Regulations in order "to make purchasing policy on the acquisition of goods and services more cost-effective and transparent, inter alia, by reducing the number of exceptions to competitive bidding and ensuring that the reasons for such exceptions are recorded in writing" (resolution 47/211, para. 9 (b).

Conversely, other rules are so rigorous as to be incompatible with the intelligent administration of purchasing activities. This is true, for example, of rule 110.21, which baldly states that "contracts shall be awarded to the lowest acceptable bidder", without leaving any room for consideration of the relationship between quality and price.

In order to evaluate the possibilities of fraud, it would also be necessary to take into account the manner in which such provisions are applied. For example, in the case of the United Nations Postal Administration, the (lowest) bids of some enterprises were rejected on the ground that they had been received after the expiry of the time-limit for response, even though there was no evidence for making such a categorical assertion in the absence of a systematic recording of incoming mail by means of a time stamp (the delay cited as the reason for rejecting the bid in question was no more than a few hours).

B. Rules relating to the inventory of non-expendable property

The financial provisions relating to this question, in particular rules 110.25 to 110.31, are not sufficiently precise, inasmuch as the concept of non-expendable property is not defined. It is, in fact, an administrative instruction, ST/AI/374 of 16 January 1992, which defines the term "non-expendable property" as meaning items valued at US$ 1,500 or more and with a serviceable life of five years.

The Board of Auditors has pointed out in its report 2/ that under that definition, 99 per cent of the quantity of existing non-expendable property (items valued at $500 or more) is excluded from the concept of non-expendable property.

The Board of Auditors 3/ also pointed out some deficiencies in the conduct of physical inventory and a lack of accountability for property issued to offices and departments. Such deficiencies seem to be particularly serious in the sphere of peace-keeping operations.

The Fifth Committee endorsed the recommendations of the Board of Auditors for implementing stringent inventory controls on non-expendable property (General Assembly resolutions 46/183, para. 17 (c), and 47/211, para. 9 (e)).

C. The inadequacy of formally enunciated and published financial rules

Beyond the rules formally enunciated and published in texts, such as the Financial Regulations and Rules, account must also be taken of the many provisions contained in documents which remain internal to the services. In practice, such internal documents lend themselves more or less easily to falsification. This was true a few years ago, and may still be true today, of the texts which specify the documents that must be submitted to prove eligibility for education allowances. Their provisions were circumvented by a good many staff members of the Organization, with or without the complicity of the authorities of certain educational institutions.

D. The inadequacy of the accounting principles contained in the Financial Regulations

In general, certain accounting principles adopted by the Organization and not appearing in the regulations should normally be stated explicitly in the summary of significant accounting policies. Those principles authorize "facilities", each of which can provide an opportunity for fraud.

This is true, inter alia, of the principle which authorizes the inclusion of certain unliquidated obligations in the Organization's expenditures when the actual existence of the obligation has not been established. A strict rule in this matter would require that such obligations should be so included only when they reflect services actually rendered or goods actually delivered (the delivery principle). Such a strict rule has almost never prevailed at the United Nations. On the contrary, in many cases the vaguest kind of "commitment" (as, for example, the issuance of a purchase voucher) suffices to justify the accounting of the expenditure in question. By this technique, uncommitted credits can easily be used up at the end of a period.

Notes

1/ Official Records of the General Assembly, Forty-seventh Session, Supplement No. 5 (A/47/5), vol. I, paras. 228 and 229.

2/ Ibid., paras. 255 to 258.

3/ Ibid., paras. 259 to 274.

ANNEX II

Extracts from the study entitled "Auditing for compliance with authority", published on 15 April 1994 by the International Federation of Accountants, Public Sector Committee (IFAC)

Introduction

1. In any organization management is responsible for ensuring compliance with the laws, regulations and other authorities applicable to its activities, particularly authorities for raising and spending money. Compliance or authority auditing, therefore, is an important element of auditing both in the public and the private sector. Compliance, however, takes on added significance in the public sector because Governments and other public-sector entities are generally created by, and mandated to operate with and within, a regulatory framework. Therefore they are subject to more numerous and specific authorities than are private-sector organizations.

...

4. In many jurisdictions, public officials, legislators and the general public have been devoting increasing attention to the accountability of governmental and other public-sector entities. In some jurisdictions, authority requirements imposed on public-sector entities have increased. In other jurisdictions, authority requirements have been relaxed to facilitate achievement of results. Auditing for compliance with authority, however, remains an important function for public-sector auditors everywhere.

...

Scope of the audit

11. It is the responsibility of the management of the audited entity to ensure compliance with applicable authorities. This responsibility encompasses identifying the requirements with which the entity must comply, implementing internal control systems designed to provide reasonable assurance that compliance is achieved and taking appropriate action whenever a breach of legislation or other authorities occurs.

12. It is the responsibility of the auditor to determine the specific mandate for conducting compliance with authority work, to consider the impact of such requirements on the scope and conduct of the audit and to provide reasonable assurance of detecting abuses or irregularities that could significantly affect the audit objectives.

...

Conduct of the audit

16. At the operational stage of the audit, the auditor should review and assess whether the entity's operation is in compliance with the significant pertinent legislation and other authorities that he has identified. Some of the areas that could be considered would include:

- Organizational structure (for example, do appointments to the governing board conform with the provisions of enabling legislation, or have the specific funds required by law been established?);

- Policies and procedures governing the acquisition, management and utilization of the entity's resources (for example, contracts and grants procedures, or revenue or debt policy);

- Policies detailing programme eligibility requirements;

- Internal control systems designed to ensure compliance (for example, budgetary control system, control of deposits and investments);

- Transactions (for example, are expenditures in excess of the legally appropriated amounts, is personnel compensation in accordance with relevant legal and regulatory provisions, particularly with respect to higher executive levels?).

...

18. In addition, the audit of compliance with authority could be broadened to include assessment of the internal control framework established by management to minimize the occurrence of non-compliance. As a minimum, the auditor should be alert to situations which indicate fraudulent acts. Where fraud is suspected, sufficient tests should be conducted to determine whether there are reasonable grounds to support the suspicion and, if so, to report to the appropriate body. Legal advice should be sought if appropriate.

Reporting

19. In many jurisdictions, the auditor should prepare a written report on the examination of compliance with applicable authorities. Depending on the audit mandate and related examination, the report could take the form of: an opinion on whether the entity complied with specified authorities; an opinion on whether the transactions that have come to the auditor's attention in the course of discharging other audit responsibilities were carried out in compliance with specified authorities, a report of instances of non-compliance observed.

20. The auditor's findings may be included in a separate report (a compliance audit report), in a report on financial statements (a financial audit report) or a report on economy, efficiency and effectiveness (a performance audit report).

21. When long-form reports are published, as is generally the case in compliance audits, separate reports may have to be prepared for the audited entity, its governing board, the relevant minister or ministers, supervisory bodies and/or legislative bodies. In such cases, only the more serious weaknesses or actual breaches of legislation and other authorities revealed by the audit would be reported to the higher level of government. Other findings may be conveyed to lower levels of government (including officials of the audited entity) in separate communications.

22. When, in a financial audit, an audit opinion is called for, the auditor should determine whether any non-compliance that has been identified materially affects the opinion on the fairness of presentation of the entity's financial position and result of operations. When an opinion is called for in a specific compliance audit, the auditor should ascertain whether the non-compliance significantly affects the opinion on compliance of the entity's operations with the specified legislation. Where the auditor considers that the non-compliance would be significant, a qualified opinion should be issued.

23. Subject to the audit mandate, the auditor must exercise professional judgement in determining the materiality of non-compliance. Assessing the significance of non-compliance involves both quantitative and qualitative considerations. One of the criteria in determining materiality is the monetary amount involved. But it cannot always be measured in monetary terms. Qualitative and quantitative considerations include the cumulative effect of immaterial items, the needs of the users of the report, the nature of the pertinent authorities and the degree of public interest in the matter. The issue of materiality may not be relevant in all jurisdictions and it may be different for the audit opinion and the report.

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